

March 7, 2001

MAINE PUBLIC UTILITIES COMMISSION
Standard Offer Bidding Process

ORDER DIRECTING BANGOR
HYDRO-ELECTRIC COMPANY
TO CONTRACT FOR
WHOLESALE POWER SUPPLY
AND ESTABLISHING
STANDARD
OFFER PRICES (PART II)

WELCH, Chairman; NUGENT and DIAMOND, Commissioners

I. SUMMARY

In this Part II Order, we explain our reasoning for directing Bangor Hydro-Electric Company (BHE) to enter into a wholesale power supply contract that will provide a portion of the supply necessary for BHE to serve as the standard offer provider for the residential/small non-residential and medium non-residential classes in BHE's service territory. We also explain our reasoning for establishing the standard offer prices, as announced in our Part I Order and for effect on March 1, 2001:

For the residential/small non-residential customer class,	\$0.073/kWh;
For the medium non-residential customer class, summer (June through August)	\$0.08498/kWh
non-summer	\$0.06889/kWh

II. BACKGROUND

When the Commission terminated its Chapter 301 bid process on December 22, 2000, we directed BHE to explore wholesale power supply arrangements that would permit BHE to serve as the standard offer provider for its service territory beginning March 1, 2001. On February 2, 2001, we directed BHE to provide standard offer service to the residential/small non-residential customer class and the medium non-residential customer class in its service territory for the period beginning March 1, 2001. We also directed BHE to enter into a six-month power supply contract and described the strategy and direction that BHE should follow in procuring the remaining power supply necessary for BHE to provide standard offer service to the small and medium classes. We that stated we expected BHE to continue to monitor the market, keep us

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informed of market conditions and recommend any actions that should be taken to reasonably manage standard offer supply costs and risks. We also asked BHE to inform us regularly of the extent of under or overcollections with respect to standard offer service.¹

In our February 2 Order, we did not set a termination date for the period BHE would serve as standard offer provider, because BHE was still exploring power supply bids for periods of up to 36 months from March 1, 2001. In a filing made on February 15, 2001, BHE reported the results of the Company's latest bid solicitation process. BHE requested that the Commission direct it to enter into a proposed contract attached to its filing with the supplier that submitted the winning bid proposal. In our Part I Order on February 15, we concluded that the power supply contract with the winning bidder complied with our general directions to BHE in our February 2 Order and would constitute a reasonable and prudent power supply acquisition for BHE to provide standard offer service.

By our Part I Order, we also set the standard offer prices for the 12-month period beginning March 1, 2001, at prices listed above.

III. DISCUSSION AND DECISION

A. Power Supply Contract

On February 15, subsequent to the issuance of our Part I Order, BHE entered into a power supply contract with the winning bidder. Pursuant to the February 15 contract, the winning bidder supplies bulk energy for the 12-month period beginning March 1, 2001 (year one) and the next two 12-month periods beginning after February 28, 2002 (years two and three). In combination with the power supply contract approved February 2, the energy offered by the winning bidder is expected to equal approximately 80% of the anticipated standard offer load for the small and medium classes for year one, approximately 60% of the anticipated standard offer load for the small and medium classes for year two, and approximately 40% of the anticipated standard offer load of the small and medium classes for year three. Consistent with the current forward electricity prices, the winning bidder supplies energy at lower cost in years two and three compared to year one.

The Commission was kept informed by BHE representatives while they were conducting the bid process that resulted in the final proposals made on February 15, 2001. Based on our knowledge of that process and having reviewed the bids received by BHE on February 15, we find that BHE conducted a reasonable bid process and received a sufficient number of bid proposals to make us confident that the winning bid constitutes a reasonable price for the power supply offered. Moreover, the winning bid proposal appears reasonable given our experience of conducting our own bid

¹We note that BHE, as the standard offer supplier, is expected to manage its supply portfolio to comply with the portfolio requirement.

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processes and our own review of the recent New England electricity forward prices. As expressed in our December 22 Order terminating our bid process, we hoped that the natural gas price spike and the effect of the FERC December 8 decision on ICAP would prove transient, resulting in lower wholesale standard offer service bids. Indeed, natural gas prices are lower, FERC stayed the effect of its December 8 Order, at least temporarily, and BHE received lower-priced energy bids in January and February than the Commission received in December. The February 15 contract constitutes a prudent means to acquire power supply to serve the small and medium standard offer classes.

We expect BHE to continue to monitor the market, keep us informed of market conditions and recommend any actions that should be taken to manage standard offer supply costs and risks. We also expect BHE to inform us regularly of the extent of under or overcollections with respect to standard offer service.²

We note that the proposed contract, like all of the bid proposals received by BHE, contains a term requiring BHE to grant a limited security interest in the standard offer accounts receivable. Although BHE stated that the Company does not request approval of such an encumbrance under Section 1101 because Section 1101 appears inapplicable to the type of property at issue, the Company has asked the Commission to indicate whether or not BHE should grant such a security interest. We find that the security interest, as described in the proposed contract in BHE's filing of February 15, constitutes a reasonable accommodation in forming an agreement with the winning bidder.

B. Standard Offer Price

To serve the small and medium classes for the year beginning March 1, 2001, BHE must acquire the additional approximate 20% of energy necessary to serve the classes, as well as all the ICAP and ancillary electric products. As part of its February 15 filing, the Company provided an estimate of the total costs for BHE to provide standard offer service to the small and medium classes. BHE estimated ICAP using current forward prices and the ancillary electric products using spot prices for last year. At our direction, BHE estimated spot prices for the additional 20% of energy using current electricity forward prices. Using these estimates, the contract purchase prices, last year's standard offer load, and adding BHE's administrative costs, standard offer service for the small and medium customer classes will cost approximately \$72.69 MWH. To arrive at the \$72.69 MWH cost, BHE levelized the power supply cost of the February 15 contract over the 3-year term and included 2.77 mills for the recovery of its

² We note that BHE, as the standard offer supplier, is expected to manage its supply portfolio to comply with the portfolio requirement.

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estimated under-collection from the small and medium standard offer classes for standard offer service for the year ending February 28, 2001.³

Our goal is to set standard offer prices to reflect the underlying total supply costs of providing standard offer service. The bulk of the supply costs for BHE's small and medium standard offer classes are fixed by contract. However, some supply costs are not fixed and must be estimated. In developing these estimates, we relied upon the current forward prices for energy and ICAP, and last year's costs for other electric products. These represent the best estimate that we can make of the total supply cost to BHE.

As suggested by BHE's filing, we adjust the first year power supply contract costs by levelizing the lower second and third year contracts costs with the first year contract costs. We believe that departure from the strict adherence to our principle that prices should reflect costs over the time period for which prices are set is justified for the small and medium classes. First, the levelized contract price is based on actual, market-based contractual costs – not estimates for reduced future costs. We simply are reducing year 1 costs by levelizing the year 1 costs with the reduced (but actual) costs of year 2 and 3. Year 1 cost mitigation is proper because residential/small non-residential standard offer customers do not at present have realistic competitive alternatives. Furthermore, only 4% of the medium non-residential standard offer class in BHE's service territory is currently served by competitive suppliers. With uncertain competitive alternatives, we believe that small and medium customers require this modest attempt to bring to generation price stability to Year one. Because of the dwindling size of the commitment to second and third year energy purchases, the cost mitigation effect is not large. We do not believe that this slight amount of cost mitigation will unduly impede competitive entry.

Moreover, the cost mitigation effect of the 3-year contract price levelization is almost offset by the inclusion of another out-of-period cost, last year's undercollection. Even disregarding the potential additional costs associated with FERC's decision on ICAP deficiency charges, BHE will have an undercollection as a result of providing standard offer service to the small and medium classes for the 12 months ending February 28, 2001. We decide that BHE should recover the undercollection from standard offer customers during the year beginning March 1, 2001.⁴ We believe that the allocation of the undercollection to next year's standard offer customers is fairer than an allocation of the undercollections to T&D ratepayers, because there is a slightly better match between standard offer customers for last year

³The actual under-collection for the standard offer year ending February 28, 2001 may exceed this amount if FERC retroactively imposes an ICAP deficiency change in excess of \$.17/kW-month.

⁴ In a companion order issued today, we deny the IECG's request, made in Docket 99-111, for an investigation and hearing on the prudence of BHE's power supply acquisition before the Commission imposes any undercollection in standard offer prices.

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and this coming year than there is between standard offer customers and the full body of T&D ratepayers. Therefore, allocation of the undercollection to future standard offer customers represents a more accurate attempt to assign costs to the "cost-causers."

In recognition that significant amounts of BHE supply costs are estimated, we round the standard offer prices up to \$73.00 per MWH, or 7.3¢ per kWh. We emphasize that, if market conditions turn out different than projected, we will consider raising standard offer rates to ensure that prices reflect costs. As has been our practice, to avoid undercutting competitive providers, we will not lower prices.

Although BHE has entered into a supply contract for year two, beginning March 1, 2002 and year three, beginning March 1, 2003, we set standard offer prices only for the next standard offer year, the 12-month period beginning March 1, 2001. We make no decision now about the standard offer prices for years 2 and 3. We make no estimates now of the costs to supply standard offer service in years two and three. We have merely decided to authorize BHE to enter into a power supply arrangement for years two and three in order to mitigate the price impact of the power supply arrangements for year one. At this time, we do not even decide that BHE will provide standard offer service to the small and medium classes within its service territory for years two and three. If BHE does not serve as the provider of standard offer service in years two and three, we may direct BHE to assign the contract to a supplier who will serve as the provider of standard offer service for the small and medium classes, or we may order BHE to sell its contractual commitment pursuant to 35-A M.R.S.A. § 3204 into the market and treat the net proceeds as either an addition to or subtraction from BHE's stranded costs.

C. ICAP and Ancillary Products

As discussed above, the power supply contracts to provide standard offer service to the small and medium classes do not provide ICAP or ancillary electric products. A bilateral market for ancillary products has not developed. Accordingly, BHE will acquire ancillaries from the spot market.

There is a bilateral market for ICAP. Because of the risk that FERC may again decide that the proper ICAP deficiency charge for the ISO-New England market is \$8.75/kW month, BHE should, when it is possible to do so, at reasonable prices, hedge against that risk by entering into bilateral contracts for ICAP. BHE should report periodically on its ICAP requirements and seek Commission guidance about or approval of future ICAP acquisition as needed.

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As all the necessary ordering paragraphs were included in the Part I Order, no further ordering paragraphs are needed in this Part II Order.

Dated at Augusta, Maine, this 7th day of March, 2001.

BY ORDER OF THE COMMISSION

Dennis L. Keschl
Administrative Director

COMMISSIONERS VOTING FOR: Welch
 Nugent
 Diamond

This Order has been designated for publication.

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NOTICE OF RIGHTS TO REVIEW OR APPEAL

5 M.R.S.A. § 9061 requires the Public Utilities Commission to give each party to an adjudicatory proceeding written notice of the party's rights to review or appeal of its decision made at the conclusion of the adjudicatory proceeding. The methods of review or appeal of PUC decisions at the conclusion of an adjudicatory proceeding are as follows:

1. Reconsideration of the Commission's Order may be requested under Section 1004 of the Commission's Rules of Practice and Procedure (65-407 C.M.R.110) within 20 days of the date of the Order by filing a petition with the Commission stating the grounds upon which reconsideration is sought.
2. Appeal of a final decision of the Commission may be taken to the Law Court by filing, within 30 days of the date of the Order, a Notice of Appeal with the Administrative Director of the Commission, pursuant to 35-A M.R.S.A. § 1320(1)-(4) and the Maine Rules of Civil Procedure, Rule 73, et seq.
3. Additional court review of constitutional issues or issues involving the justness or reasonableness of rates may be had by the filing of an appeal with the Law Court, pursuant to 35-A M.R.S.A. § 1320(5).

Note: The attachment of this Notice to a document does not indicate the Commission's view that the particular document may be subject to review or appeal. Similarly, the failure of the Commission to attach a copy of this Notice to a document does not indicate the Commission's view that the document is not subject to review or appeal.